# Daniel Borenstein: Police and firefighters' pension proposal would only make matters worse

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Two years ago, San Jose police and firefighters floated a proposal to move their pensions from the city's retirement plan to the statewide California Public Employees' Retirement System. They claimed the switch would save the city a quarter-billion dollars over five years.

If it sounds too good to be true, that's because it is.

The idea seemed to have died a proper death. But now Contra Costa County firefighters are promoting a similar move, and Santa Clara County Supervisor Dave Cortese has resurrected the San Jose proposal in his campaign to become the city's mayor.

Indeed, Cortese has doubled down. In an editorial board interview with the San Jose Mercury News, he portrayed the claimed savings at "half a billion dollars right off the top."

That's fantasy. But it rhetorically bolsters the San Jose labor agenda to move public employees' retirements from the reform-minded city's pension plan to CalPERS, which has been more resistant to cost-saving changes.

The key question is whether moving to CalPERS per se would produce real savings for the city. It wouldn't. It would only make matters worse. Any short-term savings would result in greater long-term costs, kicking the proverbial can further down the road.

To understanding why, start with a fundamental pension principle: Public retirement plans are supposed to be prefunded. As working employees earn future pension benefits, sufficient money should be invested to later cover the retirement payments.

San Jose's retirement plan does a much better job of prefunding than CalPERS. Here are the differences:

- Investment earnings assumption. To calculate the amount that should be set aside now to pay for future benefits, pension systems predict how much they expect to earn on those investments.

The greater the anticipated rate of return, the less money the pension system requires up front. The San Jose system forecasts an average annual return of 7.125 percent; CalPERS uses a 7.5 percent rate, dismissing its actuary's more conservative recommendation. As a result, San Jose requires a higher and more realistic annual contribution from the employer and employees than CalPERS.

- "Smoothing" gains and losses. When calculating rates, pension plans typically phase in recognition of market gains and losses, an accounting practice called smoothing. The San Jose retirement plan uses a five-year smoothing period. CalPERS uses 15 years, an outlier in the pension world, although it plans to effectively move to a five-year period.

Because of its longer smoothing period, CalPERS, unlike San Jose, has yet to recognize most of its losses from the Great Recession and, consequently, has not yet sufficiently increased rates to replenish its accounts.

- Amortizing the debt. When pension systems are underfunded, they treat the shortfall like a mortgage. They establish a repayment schedule and add the installments to annual pension payments.

San Jose amortizes most debt over 16 years; CalPERS effectively stretches it out over 30 years. Consequently, the individual installment payments to CalPERS are lower. But, as any mortgage holder knows, a longer payoff period adds interest costs.

All three factors mean CalPERS would require smaller immediate pension contributions than the San Jose system. But they also mean that there will be less money put into the system in early years on which to earn investments. The result: much bigger payments by taxpayers later, driving up the total cost and forcing future generations to pay significantly more for current obligations.

There's another problem with the San Jose fire and police unions' proposal. The move to CalPERS would not replace the San Jose retirement plan; it would divide it. Members already retired and an unknown number of current employees would remain in the San Jose plan.

As a result, the ratio of retirees to active employees in the San Jose plan would increase, making it what actuaries call a more "mature" plan. Just as an individual nearing retirement should move investments into more conservative holdings, so too should pension plans invest more cautiously as their memberships mature.

More conservative holdings mean lower investment return potential. And that means, yes, higher public contributions to cover the costs of those who remain in the city plan.

In short, this idea is no magic bullet -- unless taxpayers want to shoot themselves in the foot.

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